# *The* Real Estate ANALYST

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Roy Wenzlick
*Editor*

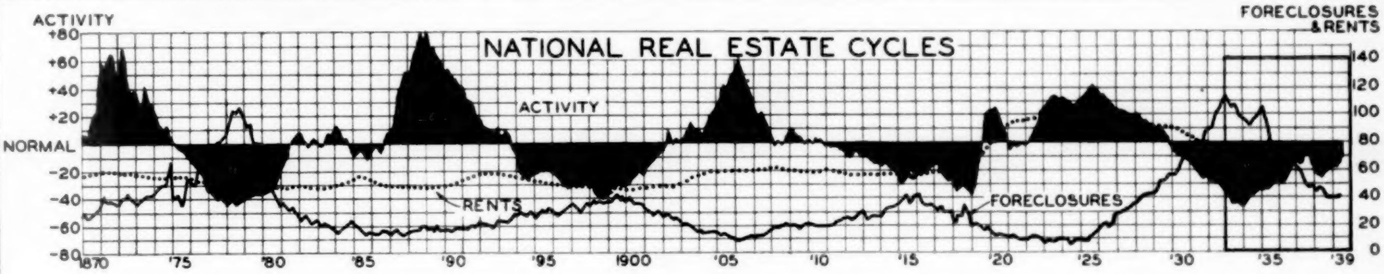
A concise easily digested periodic analysis based upon scientific research in real estate fundamentals and trends...Constantly measuring and reporting the basic economic factors responsible for changes in trends and values.....Current Studies.....Surveys....Forecasts

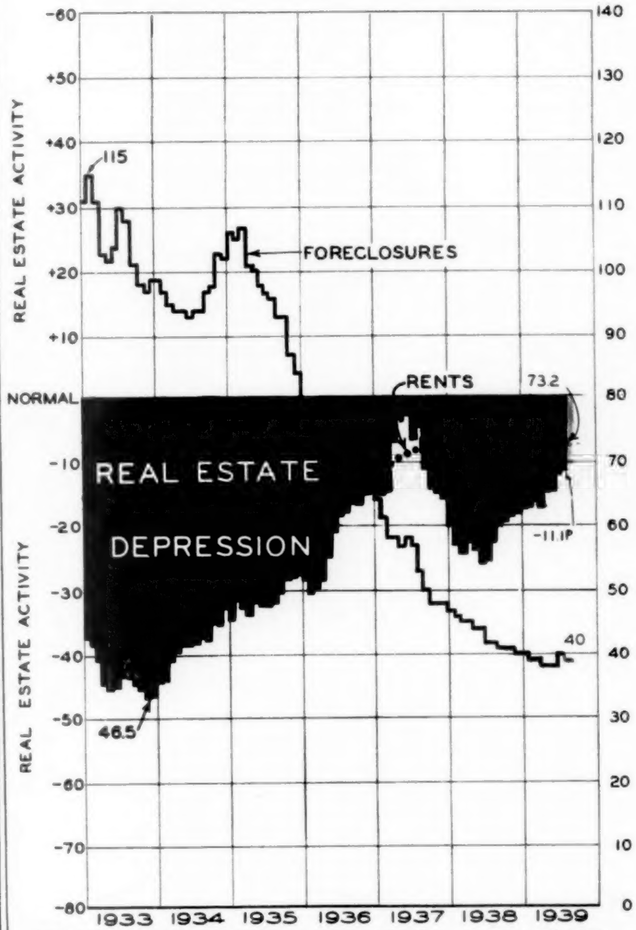




VOLUME VIII

REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS


## EXPLANATION OF THE CHARTS

The charts above show booms and depressions in real estate from 1870 to the present. The large black areas above the line represent the real estate booms and the black areas below the line represent the real estate depressions.

The level of residential rents, indicated by the dotted red line, is charted, not as a percentage above or below a normal line, but as an index (1926 100) from the bottom of the chart and is read on the right hand scale, as is the index of the number of foreclosures per month per 100,000 families, shown by the solid red line. The lower chart is the last six years of the upper chart enlarged to show monthly fluctuations.

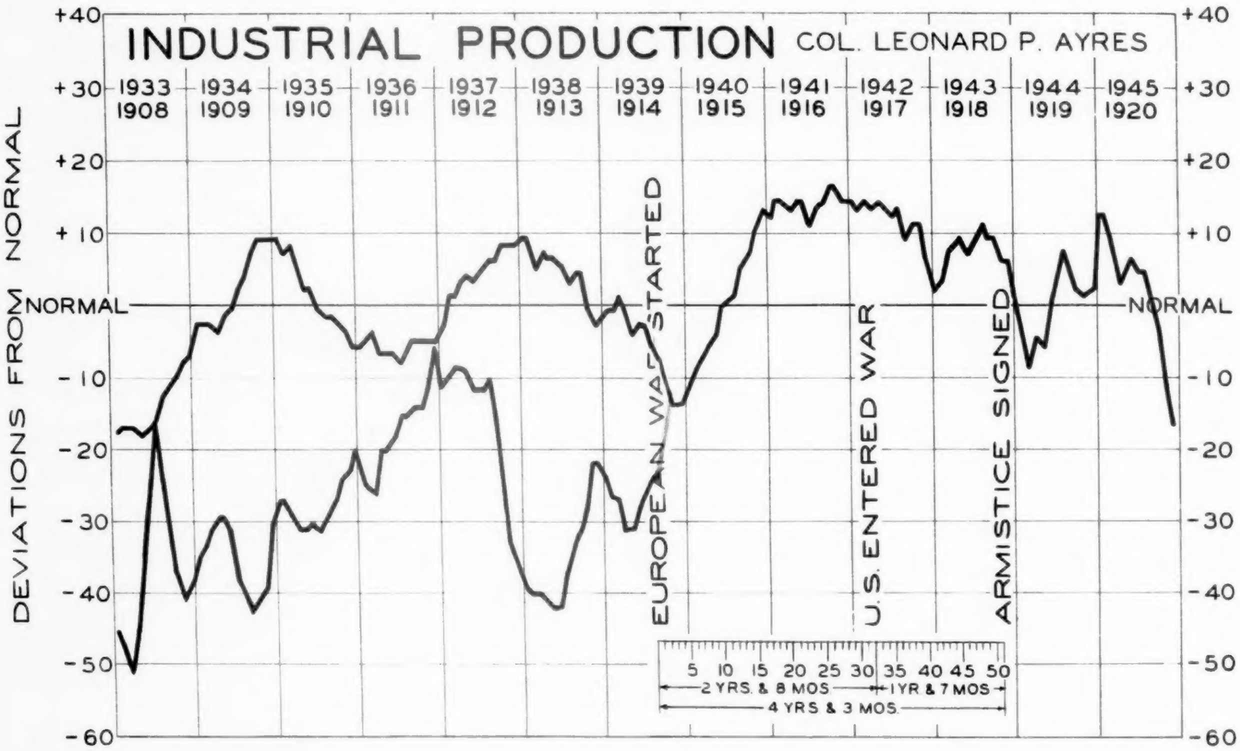
EVEN the alarming conditions which prevailed in international affairs during the latter part of August were not able to prevent a further rise in real estate activity. The final figure for July shows real estate activity to be 11.6% below normal. The figure for August is 11.1% below normal. The rise, of course, is microscopic; but a rise of any size, in view of conditions which prevailed, is quite surprising.

Residential rents showed no change whatever over the preceding month. This has been quite characteristic of our rental index during the past year and a half. We think that the sideways movement will shortly give way to a further upward movement.

The foreclosure rate increased slightly, but with the exception of two months was lower than it has been at any time since the depression started.

The volume of new residential building during August showed practically no change for the country at large from the volume in July, although it maintained a level practically 25% above the level of a year ago.

Construction costs increased by a small fraction of a per cent.

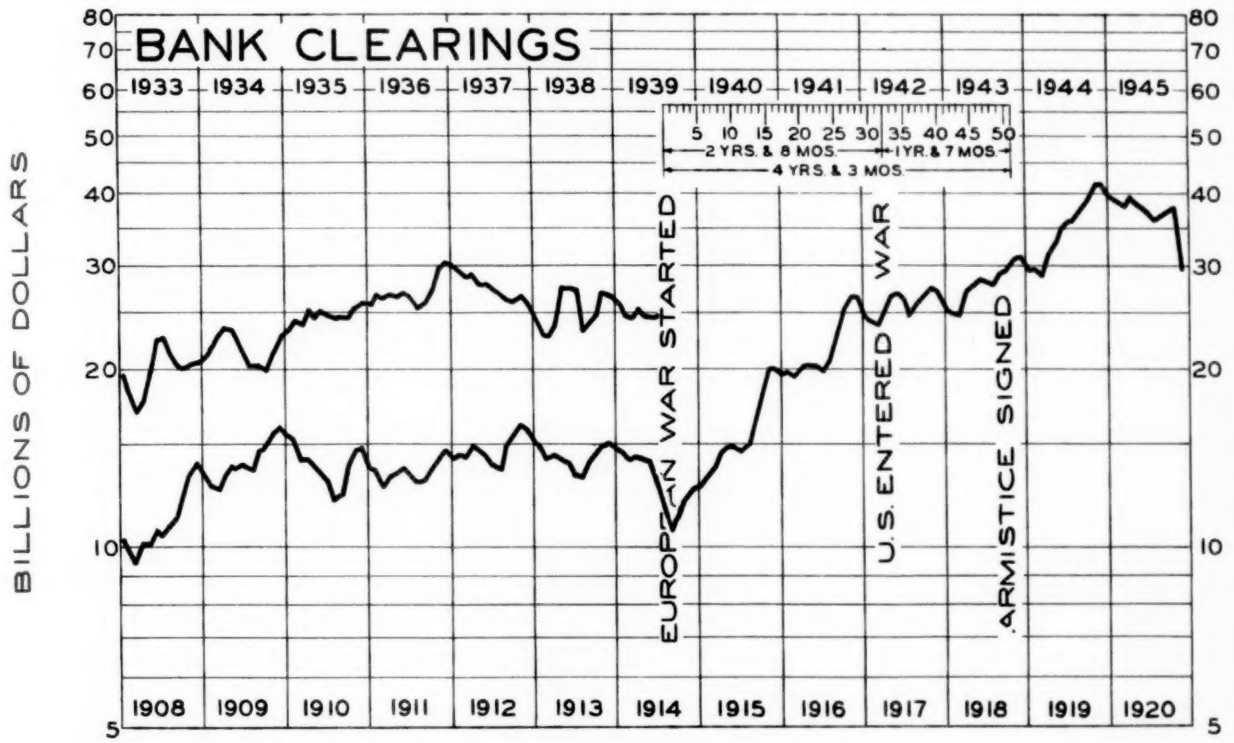



## INDUSTRIAL PRODUCTION WILL INCREASE AS A RESULT OF WAR

THE chart above shows the comparison of industrial production in the pre-World War period,during the war and the period immediately after, with industrial production from 1933 to the present. The World War curve is shown in red, the recent past in black. The two lines are so drawn that the beginning of the World War in 1914, and the invasion of Poland in 1939 are superimposed.

It will be noticed first, that in the pre-World War period, industrial production was much higher than it has been in the period from 1933 to the present. It will also be noticed that industrial production was dropping for the two year period preceding the outbreak of the World War. In contrast with that, the general movement of industrial production during the past year has been upward. In 1914, after the outbreak of hostilities, industrial production declined for several months, and then started strongly upward, reaching boom proportions in less than a year from the time the war started.

It seems to us that the war in Europe must necessarily result in increased industrial production in the United States. The fact that the stocks listed on the New York Stock Exchange have increased by five billion dollars since the first of September would indicate clearly that informed investors are expecting a tremendous increase in industrial activity and profit, during the next few years. As we go to press, it seems reasonable to suppose from the weekly figures that industrial production during September will advance by about 8 points, a tremendous increase in a single month.




# BUSINESS WILL SHOW MARKED IMPROVEMENT IN 1940

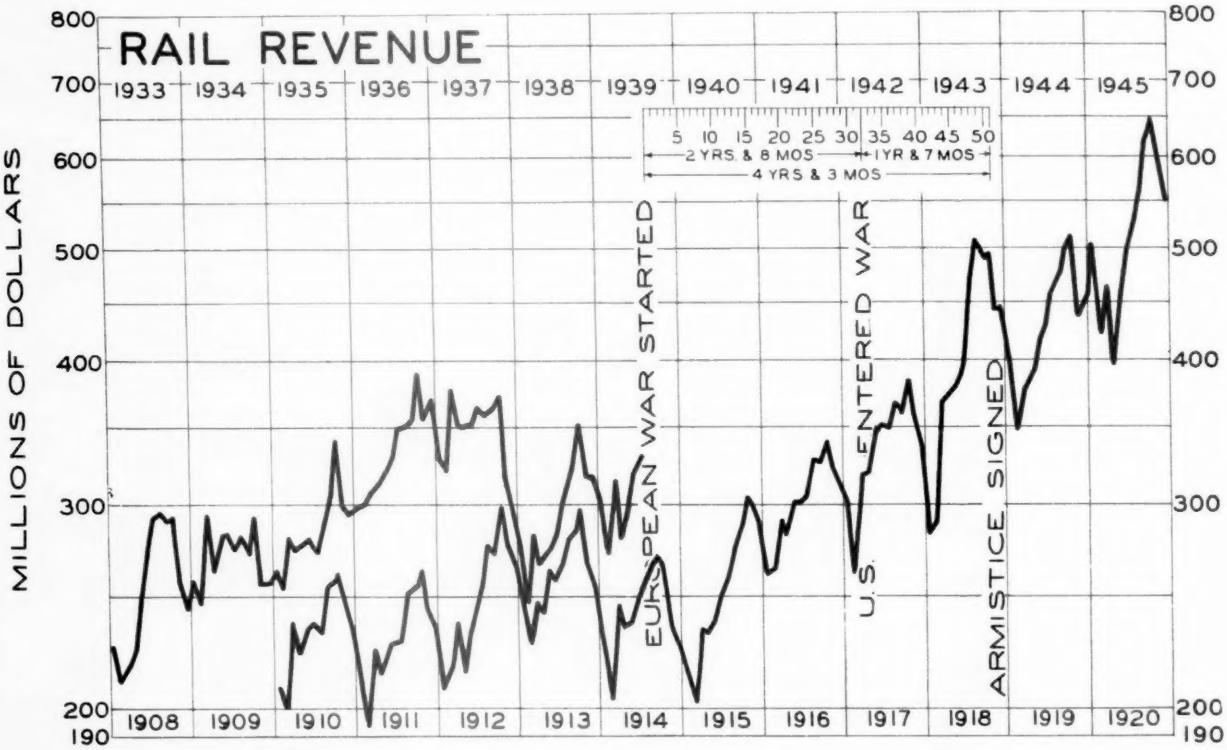
THE chart above shows a comparison of the fluctuations in bank clearings in the period from 1908 to 1914 with the comparable period from 1933 to 1939. It also shows the period from 1914 to 1920, with the result of the last World War on American general business.

It will be noticed that general business, as indicated by the volume of bank clearings, increased almost immediately with the beginning of the European War. Bank clearings had more than doubled at the end of the second year. They had increased by almost 60% at the end of the first year. At the end of five years, they were approximately three and one-half times greater than they were at the outbreak of the war.

The figures available for the first few weeks of September do not indicate a marked increase for September over August. We think, however, that the final figures for the month will show a greater increase than now seems likely.

Neither check transactions nor bank clearings can be used as an indicator of the actual dollar volume of business done as both figures contain innumerable duplications which swell the totals tremendously. They are, however, useful as indexes of the relative volume of business in one period as compared with another.

Bank clearings are not so good an index of general business as are check transactions, but check transaction figures were not available for the period from 1908 to 1920. In their absence, bank clearing figures are the best index figures available.

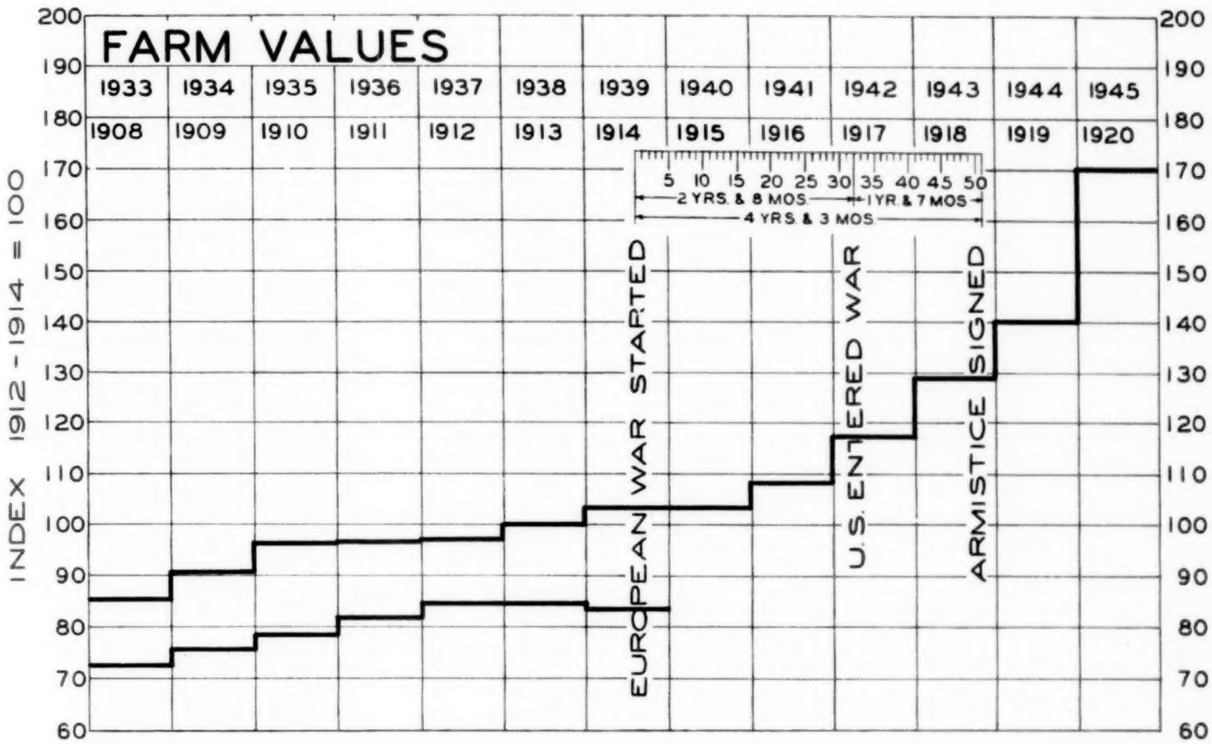



## STIMULATION FOR HEAVY INDUSTRIES

RAIL revenue figures are available from 1910 on. In the period prior to the starting of the World War, rail revenue was fairly stable. From the beginning of the war through 1920, however, a very pronounced upward movement in revenue ensued. The peak was more than twice the level of August, 1914.

Since 1933 rail revenues have been above the corresponding pre-World War period. Freight car loadings are now increasing quite rapidly; in fact, both the railroads themselves and the government are quite worried about a shortage of cars. In a short time it may be that salesmen will have to spend so much of their time making excuses for deliveries that they will forget how to sell. In case the United States enters the war, the shortage of rail equipment may be quite serious.

Undoubtedly, freight car loadings will continue to increase rapidly during the next few years. This will go far towards bailing out the railroads and should provide a tremendous amount of additional employment in the rail equipment line. The heavy industries are the ones which needed stimulation most during the period prior to the outbreak of hostilities. They will now be the industries in which the greatest war congestion occurs.




## FARMS WILL INCREASE IN VALUE

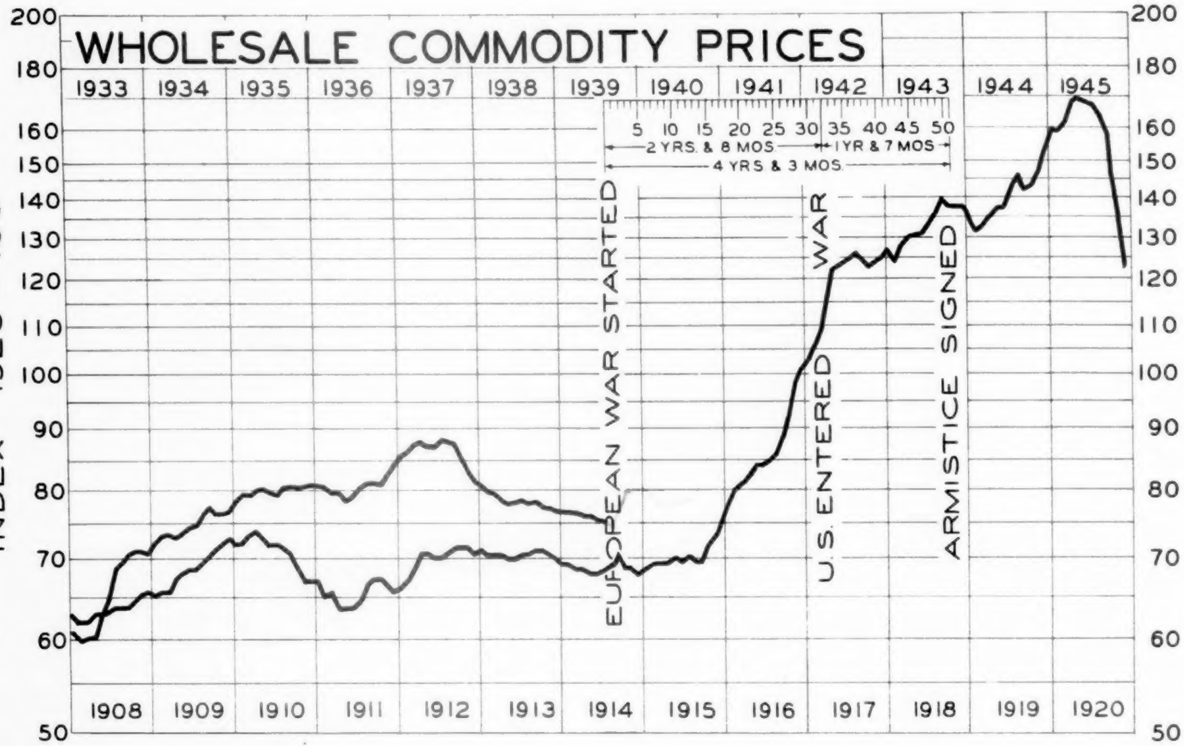
The chart above shows the value of farms per acre before and after the last World War in comparison with the period starting in 1933.

The values of farm lands depend almost entirely upon the capitalized net income which can be earned from these lands. There is a strong tendency, however, to capitalize net income at too low a rate. Opinions of value of farm lands, as shown in a study in the REAL ESTATE ANALYST of July, 1935, are generally above its real economic value.

Since capitalized net income is the rough basis on which farms are valued, a change in the value of farm products has a tremendous effect on the value of farms. This will be noticed in the period from 1915 on, when farm lands were increasing quite rapidly in value. This was the period in which farmers were mortgaging their farms in order to purchase adjoining ground. It was the time when farmers should have been paying off the mortgages on their farms.

As the prices of farm products rise due to the war (we doubt whether many of the price increases on farm products which have occurred so far are justified) the values of farm lands will increase. We think the major rise in the value of farm products will come several years from now, as it will take that long to exhaust the large over-supplies now available. When these supplies become exhausted, prices on farm products will rise quite rapidly and carry the value of farm lands with them.

The value of farm products will again collapse after the war is over as it did in 1920, and farm foreclosures will increase quite rapidly.




## PRICES WILL INCREASE AS THE RESULT OF WAR

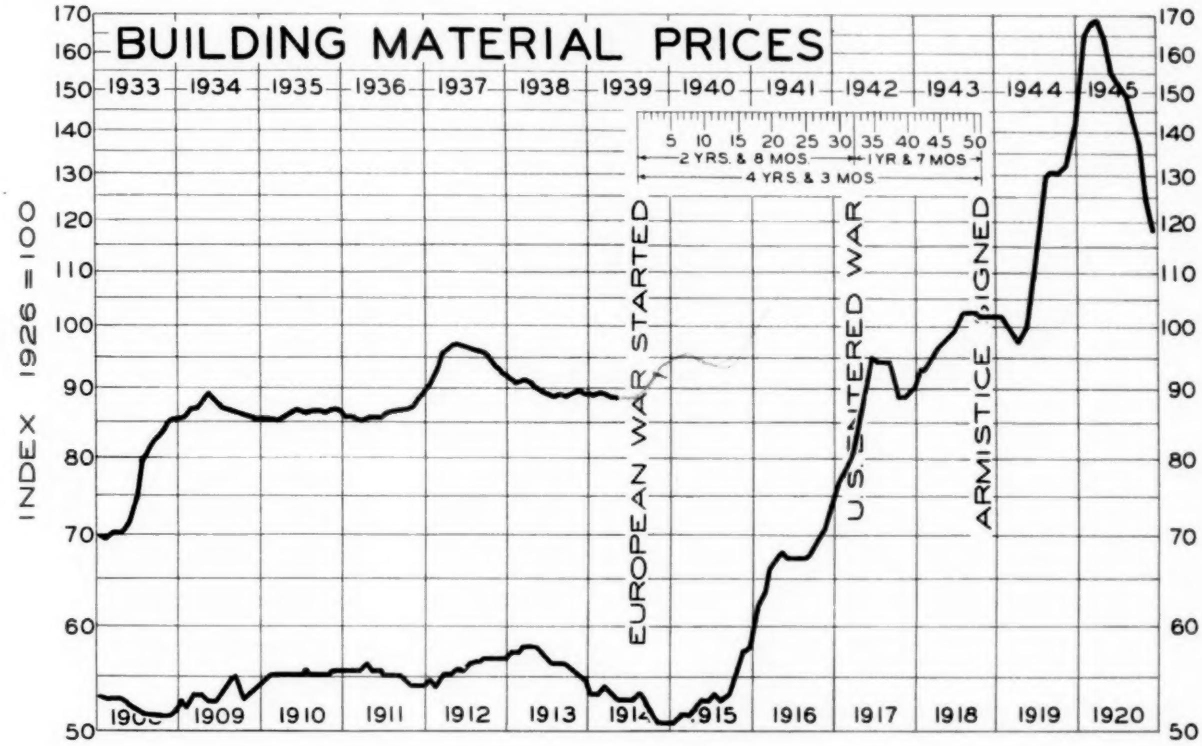
THE chart above shows the result of the last World War on wholesale prices in the United States. It will be noticed that after war was declared in 1914, wholesale commodity prices moved sideways for about a year, and that they then increased very rapidly during the next five years. At the time when the United States entered the war, two years and eight months after it started, wholesale commodity prices had advanced by 52%. From April, 1917, until April, 1920, they advanced by an additional 59%, bringing them to a point 142% above their pre-war level.

In a price advance of this sort, basic raw materials move first followed later by semi-manufactured and manufactured articles.

## BUILDING MATERIAL PRICES WILL INCREASE

At the top of the next page a similar picture is shown for building material prices. It will be noticed that building materials increased in price along with the increases in general commodities. Building materials, however, started their increase slightly before the increase in general commodities, and the percentage of increase was greater than the percentage for the entire list of commodities. In the first two years and eight months of the war, building material prices advanced by 65%, during the next three years, they advanced by an additional 93%, bringing them to a height 218% above their pre-war level.

We believe that building material prices will advance again during the next few years, and should the war continue, as we believe it will, we see no reason why the advance in building material prices should

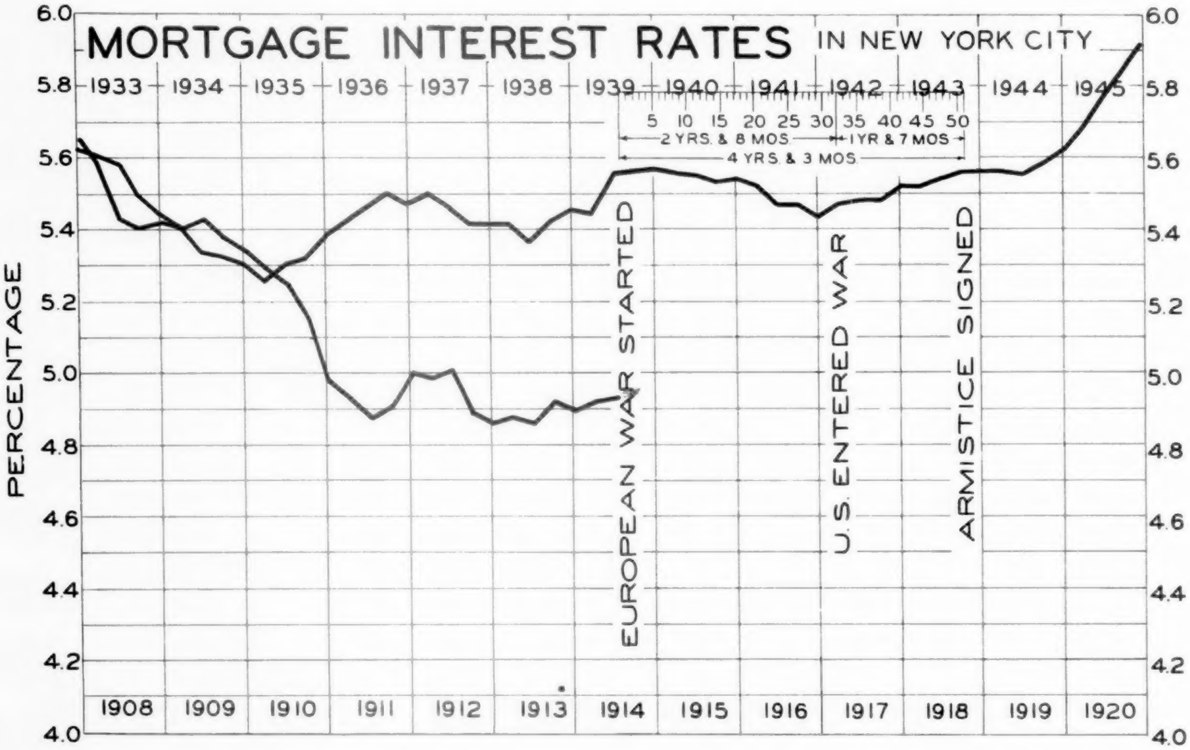



not be as great as it was before; in fact, we can see some reasons which might indicate a greater percentage rise than the one in 1914-1918.

This rise in building materials during the World War period was not unique. We have charted building material prices back to 1795, and we find that war in the past has always caused commodity prices to advance, and that each advance in commodity prices has been accompanied by an advance in building material prices. There has been no exception to this rule in the United States. The War of 1812 caused an increase of 67% in general prices, and an increase of 42% in building material prices. The Civil War caused an increase of 149% in general commodity prices, and an increase of 101% in building material prices. The Spanish-American War caused an increase of 17% in general prices and a rise of 22% in building material prices. The last World War caused general commodities to advance in price by 142%, and building materials by 218%.

It will be noticed that the earlier wars caused a larger advance in general commodities than in building materials, and that the later wars caused a larger advance in building material prices than in commodity prices. This is probably due to the fact that the materials going into a house have changed, and that freight rates form a larger percentage of the cost than they formerly did.

There is no reason for believing that this war will be an exception in its effect on prices, both of commodities and building materials; in fact, although the war has been progressing less than a month, general prices have already started to climb. We think, then, that we can assume that one of the certain effects of the war will be to increase the cost of building materials.



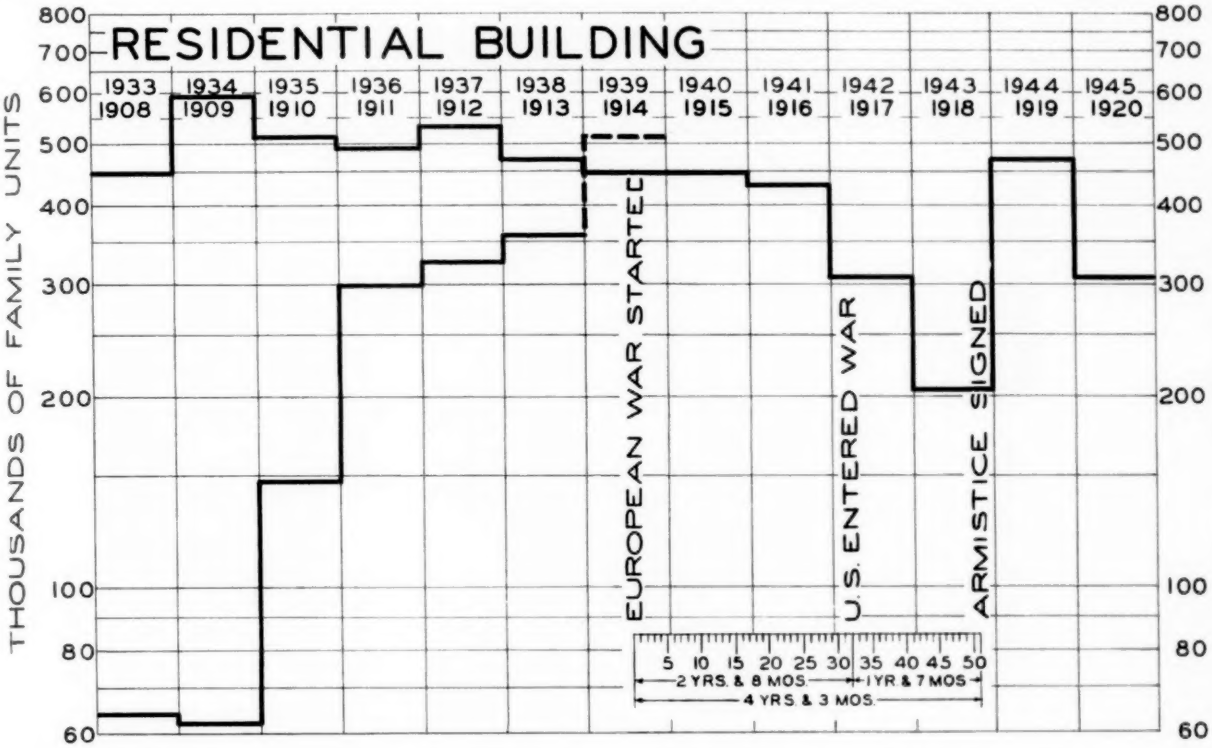

## MORTGAGE INTEREST RATES WILL RISE

THE chart above shows the mortgage interest rate in New York City from 1908 to 1920, and from 1933 to the present. It will be seen that mortgage interest rates dropped quite rapidly during 1933, 1934 and 1935.

There has been no great change since the middle of 1936, with the exception of a temporary rise during the early part of 1937. This temporary rise in 1937 is quite interesting. It was caused by the improvement in general business which occurred at that time. The setback in general business returned interest rates to the point from which they rose in 1936. Apparently, interest rates cannot be held at their present low level if any general improvement in business occurs. A real boom, in our opinion, would cause a sizable advance.

Interest rates advanced only slightly at the beginning of the World War. However, this was due to the fact that interest rates at that time for real estate were already rather high. A distress rate, like the rate at present, is far more susceptible to a bettering of conditions than a higher rate.

It seems to us that the FHA and the HOLC changed their rates at the wrong time. The FHA maximum rate of $4\frac{1}{2}\%$ became effective on August 1, just one month before the beginning of the war. The financing of war production will employ a great deal of idle money, and will remove a great deal of the pressure on mortgage interest rates, which has held them at the abnormal levels of the last few years.

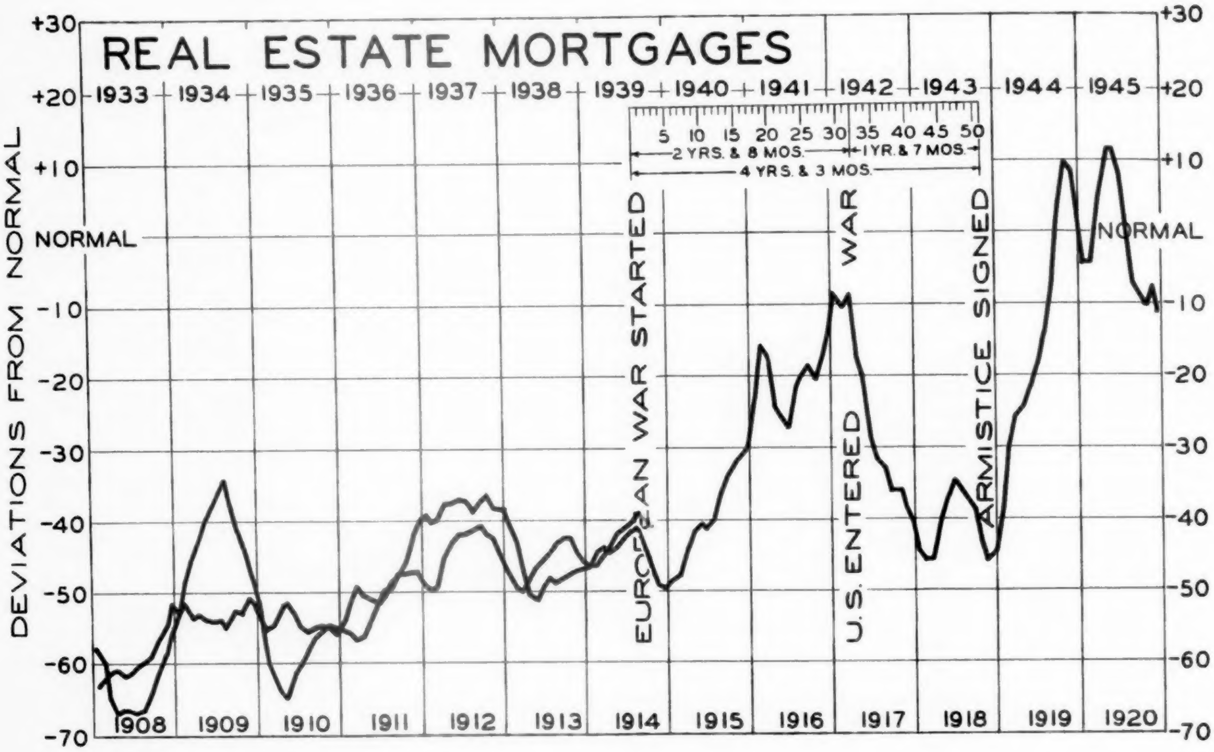



## RESIDENTIAL BUILDING FORECAST

THE chart above shows the number of family units built each year in the period 1908 to 1920, and from 1932 to the present. 1939 has been estimated from the figures for the first nine months.

It should be remembered that in the period from 1908 to 1920, building was subnormal, as we had just gone through a tremendous building boom in the early nineteen hundreds. The cessation of new building in the period immediately preceding 1936 was the longest and most drastic cessation of building we have ever experienced. In studying the outlook for new building in 1940, on the favorable side, we have the fact that at the present time, building costs are still considerably below the 1926 level, and the chances are that no very marked changes will take place in at least a six month period. Combined with this we have the lowest cost of financing ever experienced. The combination of these factors means that new family accommodations can be built today by those who are not able to pay more than a minimum down payment, at a lower cost per month than has been possible during the last twenty years. Undoubtedly, sooner or later building costs will rise materially, and 4½% money will no longer be available for the financing of real estate.

The fear of these changes may bring about a continuation in the rise in the volume of residential building. It will be noticed on the chart above that the beginning of the European war did not cause a drop in residential building in 1915 in spite of the fact that we were overbuilt at the time. It seems to us, therefore, that unless building costs rise at a more rapid rate than we now anticipate, in 1940 building volume in the residential field should exceed the volume of 1939.

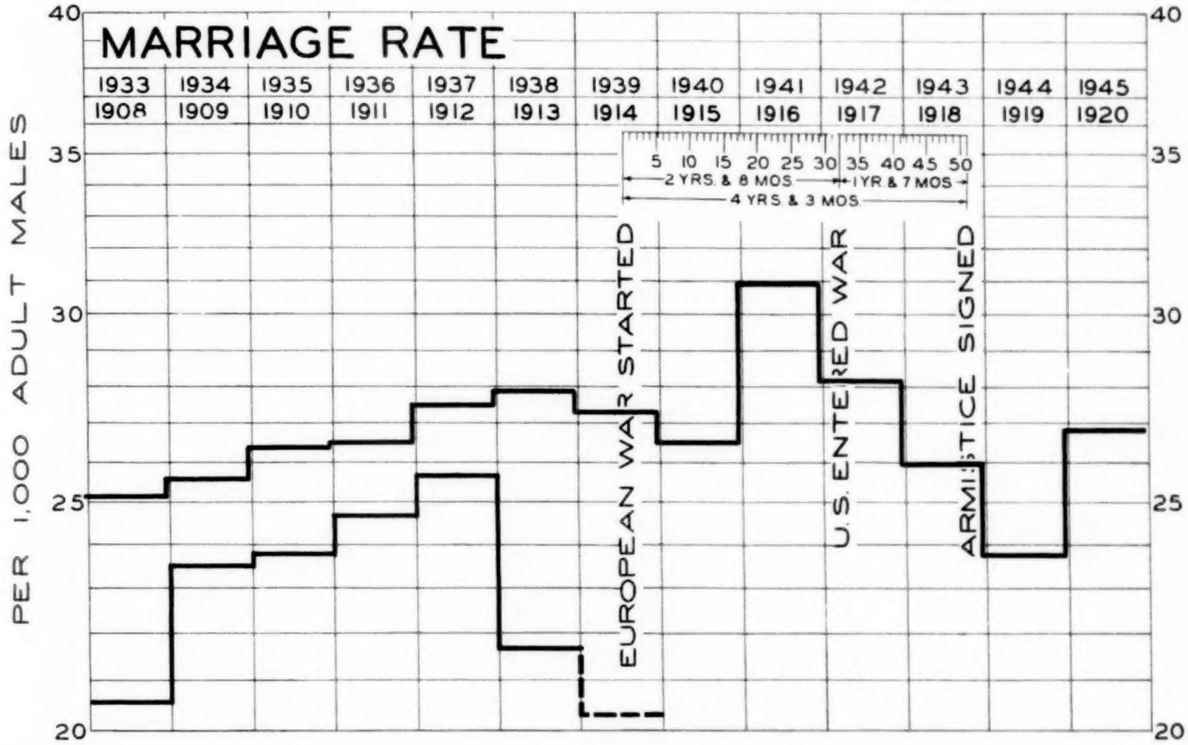



## MORTGAGE VOLUME WILL BE SATISFACTORY

MORTGAGE volume depends on two things, the financing of new building, and the refinancing of properties already built. A building boom causes a large swell in mortgage volume. This was true in the twenties. If real estate values are increasing, however, mortgage volume can increase even though new building is decreasing.

We believe that a satisfactory volume of mortgage business on new construction will be done during 1940. As the volume of new construction falls off later due to rising costs, the added value which these rising costs will give to older properties will bring about in many cases refinancing on the basis of their new values. It is our belief after studying the relationship of mortgage volume to other factors that mortgage debt over a period of years adjusts itself to changes in value. If, in a given period, real estate values double, mortgage debt will show a tendency to double. If, in another period, real estate values should be cut in half, foreclosures and forced liquidations will have a tendency to reduce mortgage debt toward the same percentage drop.

During the period from 1931 on, mortgage debt was being contracted rapidly to bring it more nearly into line with the deflation of real estate. This process has gone on steadily up to the present. Any reinflation of real estate values during the years ahead will bring about a reversal in this trend.



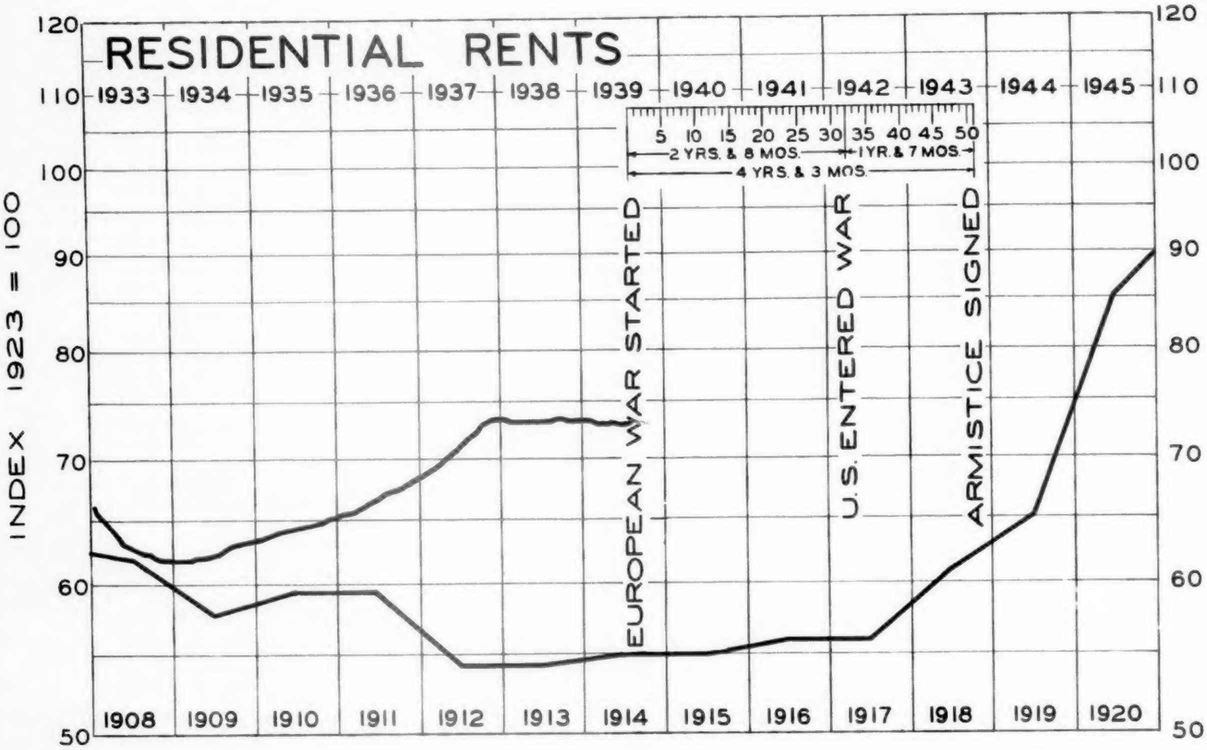

## THE DEMAND FOR HOUSING UNITS WILL INCREASE

THE chart above shows the fluctuations in the marriage rate. The effect of the great depression we have just come through is quite apparent on this chart. Our longer charts show the same drops during the depression of the seventies and the depression of the nineties.

The marriage rate in the United States has been increasing; and had it not been for the sharp "planned economy" depression of the last year and a half, the marriage rate should by this time have equaled the rate for 1914. 1939 is now too far advanced for the war to have a material effect on the marriage rate for this year; but in our opinion, the increased industrial activity during 1940 should bring a rather sharp rise in the rate, followed, we think, by a second rise in 1941.

We think also that the movement from farms to the cities will be greatly accelerated by the war. Industrial activity and high wages in the city always accentuate this movement. The only year which showed a net movement to the farms from the cities, was 1932, the year before the President started his back-to-the-farm movement. The movement from the farms to the cities is not new. The first Census showed 80% of the employed persons employed on farms and 20% employed in cities. Each succeeding Census has shown a larger percentage in cities, and a smaller percentage on farms. In 1930, the percentage on farms was 20%, and the percentage employed in cities was 80%.

This movement to the cities as the result of war, together with the decreased unemployment and increased marriage rate, will bring about a shortage of housing accommodations in cities.




## RESIDENTIAL RENTS WILL ADVANCE

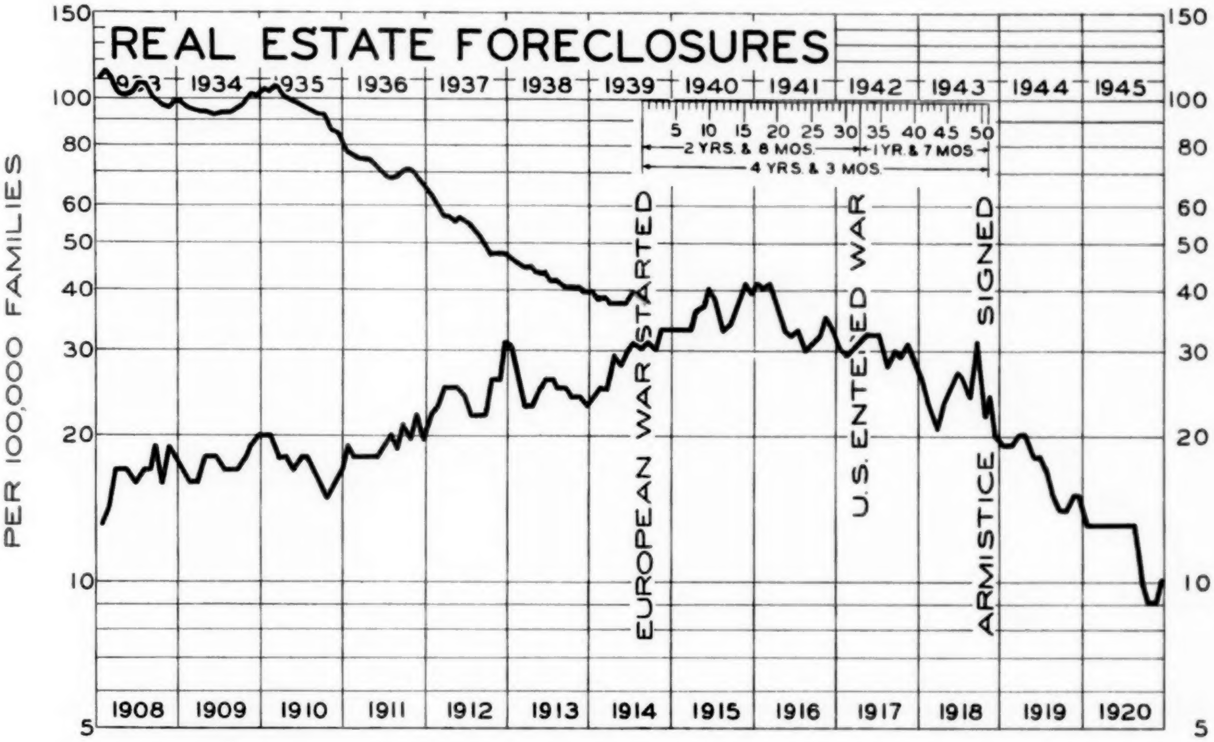
IT will be noticed on the chart above that the pre-war period, prior to 1914, was characterized by a declining rent level, in contrast to the rising rent level in the period preceding the present war.

After the war started in 1914, rents stopped declining, and in some cities, as early as 1915 and 1916, rapid rent increases were taking place. In most cities, however, no rent increases occurred until 1918, but from 1918 on, the upward movement in rents was quite rapid.

Rents rise for just one reason, because the demand for living accommodations exceeds the supply.

At tne present time, vacancy in single family residences in most of the large cities of the United States does not exceed 1%. The increased activity due to the European War, with the resulting farm to city movement, reduction in unemployment, and increase in the marriage rate should absorb quite rapidly our existing vacancy. As it does, the rental trends of the past five or six years will be resumed, and residential rents will turn upward. The fact that in a year or so from now, construction costs will be much higher than they are at the present time will slow down the volume of construction until rents have advanced still further.

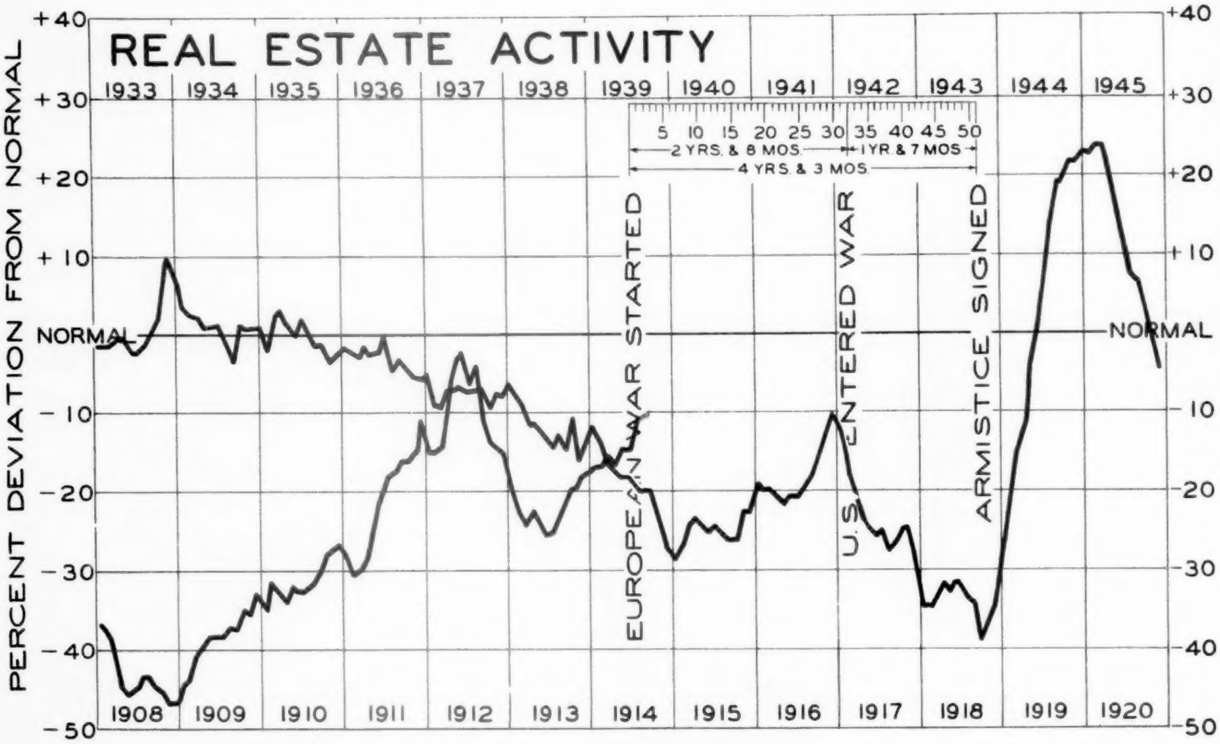
In the last analysis, it is the increase in construction costs, allowing demand to expand more rapidly than supply, which brings on a real estate boom. This was the cause of the boom in the twenties, and in our opinion, will be the cause of the boom in the forties.




As a result of the building and real estate boom in the early nineteen hundreds, with the inflation of values and the over-building which resulted, foreclosures were rising steadily from 1908 to 1916. Had there been no World War in 1914, this rise would still have taken place. From the early part of 1916 on, foreclosures were dropping rapidly, largely, we believe, as a result of increasing construction costs. As it became more and more expensive to duplicate properties already in existence, older properties started to take on an additional value which made foreclosure unnecessary.

Today, the foreclosure picture is totally different than it was in the comparable period of 1908 to 1914. In 1933, we experienced the highest foreclosure rate yet experienced in the United States. From that time on, the foreclosure rate has been dropping, although it is still almost equal to the peak of the World War depression. We think it entirely probable that foreclosures may go sideways for a while; and then as construction costs start to rise and building volume is shut off, foreclosures should continue the drop of the past four years. By the middle forties foreclosures should be down to negligible quantities.

One other factor which must be taken into consideration in forecasting foreclosures, is the effect of the insured mortgage. In a period of steady or rising prices, the absence of the necessity of refinancing should keep foreclosures on this type of mortgage to a minimum. If, however, the outlook now were for falling construction prices, many home owners with microscopic equities, seeing new properties offered for less than they still owed, would become discouraged and let go. A sharp depression might cause foreclosures to rise at a rapid rate. Watch out for heavy foreclosures in the late forties.

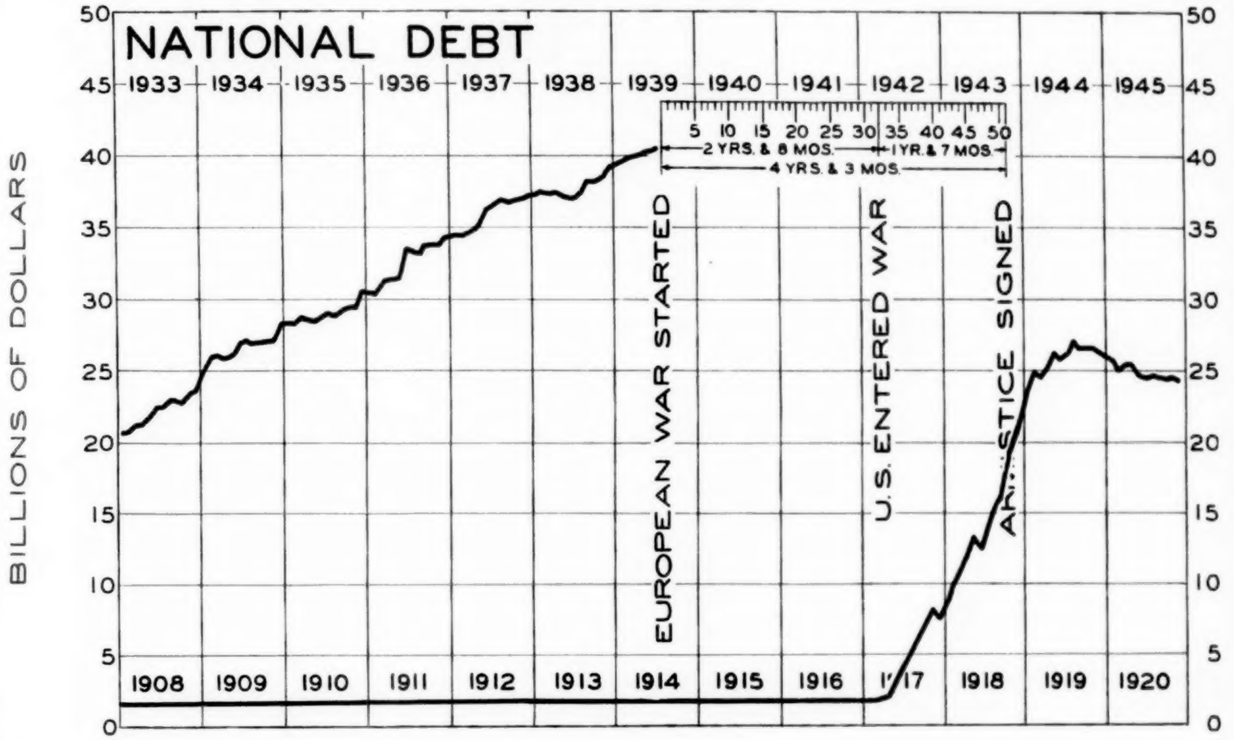



## REAL ESTATE SALES WILL INCREASE IN 1940

THE chart above shows the comparison of real estate activity (voluntary transfers of real estate) in the pre-World War period, during the war and the period immediately after, with real estate activity from 1933 to the present.

It will be noticed that real estate activity started declining many years before the World War. Comparison with the longer charts we have published will show that real estate went through a tremendous boom in the early nineteen hundreds, which, as all booms do, over-built the market. Had there been no war in 1914, we would still have expected a slump in real estate activity. By the beginning of 1915, however, due largely, we believe, to war activity, real estate sales were increasing, and they showed marked improvement through 1915 and 1916. When the United States entered the war in 1917, there was a sharp drop, which reached the lowest point at the time of the Armistice in 1918. This was followed by a very sharp rebound, culminating in a peak in 1920.

The present pre-war period (1933 to 1939) has shown a totally different trend from the trend in the same number of years before the World War. Real estate activity, with only one serious interruption, has been improving since 1933. In place of the necessity of absorbing an over-built situation, we are faced with a great potential shortage due to the long period of cessation in building. It is our opinion that real estate activity will increase during the next year, and probably during the next several years. Should the United States become involved in the European War as an actual combatant, real estate activity will probably drop by a lesser amount than it did in 1917 and 1918.




THE chart above shows the dollar volume of government debt. It will be noticed that government debt increased rapidly from the time that the United States entered the war, that it continued to increase until the middle of 1919, and then started a gradual decline.

The depression has brought about an increase in government debt not as rapid, but practically as great in billions of dollars as that caused by the United States entry into the war.

If the United States stays out of the war, the increased industrial activity should enable us to balance our budget, and even bring about a slight decrease in the total volume of our debt. Should we enter the war, however, and pile additional indebtedness on top of that we already have, inflation of considerable extent would be inevitable in the United States.

Even though we keep our debt under control, and stay out of the war, we are inclined to believe that our price structure in the United States will undergo considerable inflation. All of the warring countries started with tremendous government debts. Their war expenditures will increase these debts to the point where they cannot be paid. This is certain to bring on a high degree of inflation in Europe, which we think will cause a lesser degree of inflation in the United States. Clearly, the destruction of wealth on the scale with which it is being destroyed in Europe cannot but leave the world much poorer, and many of the commodities and the products which we produce in the United States will be consumed in the process. It is doubtful whether we will receive in exchange a sufficient quantity of gold or other tangibles to repay us for the articles we produce.